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Robert H. Corbin

December 19, 1983

Mr. David E. Weiss
Streich, Lang, Weeks & Cardon
Attorneys at Law
2100 First Interstate Bank Plaza
Post Office Box 471
Phoenix, AZ 85001

Re: I83- 139 (R83-143)

Dear Mr. Weiss:

Pursuant to A.R.S. § 15-253.B, we decline to review your opinion dated October 12, 1983, to the Washington Elementary School District concerning an employee benefit trust created pursuant to A.R.S. § 15-382.

Sincerely,

A handwritten signature in cursive script that reads "Bob Corbin".

BOB CORBIN
Attorney General

BC/VBW/kb

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October 12, 1983

Mr. Jeff Gadd
Washington Elementary School District No. 6
8610 North 19th Avenue
Phoenix, Arizona 85021

Dear Jeff:

You have asked our opinion with respect to whether the Washington District Governing Board ("Governing Board") or the trustees of the Washington Employee Benefits Trust ("Trust") have the authority to make decisions which affect the administration of the Trust.

It is clear that A.R.S. §15-382 vests statutory rights and obligations in the Governing Board, including the right to determine whether to self-insure and adopt the Trust in the first instance, as well as ultimate responsibility for the cost of the programs provided through the Trust since such costs are subject to the Governing Board's district budgetary responsibilities under A.R.S. §15-905.

Conversely, it is also clear that the legislature did not intend to grant the Governing Board authority over the administration of the Trust. A.R.S. §15-382 requires that if a member of the Governing Board or an employee of the Washington District is a trustee of the Trust, the Trust must have at least five trustees, and at least three of the trustees must be totally independent (i.e., may not be a member of the Governing Board or an employee of the Washington District). By prescribing the need for a majority of independent trustees, the legislature has clearly shown a desire to limit the overall authority of the Governing Board in administration of the Trust and has subjected these independent trustees to the statutory obligations and duties set forth in A.R.S. §§14-7301-7303 and Arizona case law.^[1]

¹ Section 4 of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA") exempts any employee benefit plan such as the Trust, which is a "governmental plan," from the fiduciary responsibility provisions of ERISA.

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A.R.S. §14-7301 states that it is the general duty of a trustee to administer a trust for the benefit of the beneficiaries. In Lane Title & Trust Company v. John Brannan, 440 P.2d 105 (1968), the Arizona Supreme Court adopted the following standard to evaluate a trustee's duties:

Generally, the powers and duties of a trustee are measured by the terms of the instrument creating the trust and in the performance of these duties, he must in good faith protect the interests of all the beneficiaries and exercise the care and diligence which an ordinary prudent person under the circumstances would exercise in the management of his own affairs. . . . But more important, the trustee owes the beneficiary a duty of undivided loyalty. . . . The trustee's first duty is to the beneficiary, and when a conflict of interest arises he must reveal the facts within his knowledge to the cestui que trust. For the failure to act scrupulously and with undivided loyalty the trustee will be held liable. (Emphasis added.)

Thus, the trustees' responsibilities must be measured by the "terms of the instrument,"[2] and the trustees' "first duty" and "undivided loyalty" is owed to the Trust beneficiaries.

Section 1.01(g) of the Trust defines the term "Plan" to include any health care program which may be designated by the "Trustees." Thus, the trustees must approve any program before it can become a part of the Trust.

Section 3.02 vests in the trustees the sole authority to determine the amount of employee contributions that must be made to the Trust, but the Governing Board is given the power to approve such amount. If the Governing Board does not approve the amount of employee contributions, its only recourse under the terms of the Trust is to remove the trustees.

Section 9.01 vests in the Governing Board the authority to appoint and remove the trustees. Section 9.02 vests in the trustees the authority to adopt "procedures, bylaws and operating rules" to administer

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Section 1.03 of the Trust prescribes that the Trust is to be interpreted and construed according to the laws of Arizona.

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the Trust. Finally, Section 10.01 vests in the Governing Board the power to amend or terminate the Trust, but no amendment may be made to the Trust which "affects the rights, duties or responsibilities of the Trustees" without their consent.

The foregoing summary of the relevant Trust provisions leads to the conclusion that the "terms of the instrument" vest in the the trustees the authority to administer the Trust. If the Governing Board does not approve of the trustees' decisions, its sole remedy is to remove the trustees. Stated another way, the Governing Board cannot override decisions of the trustees, or make decisions in the first instance, which affect the administration or operation of the Trust. The Governing Board's authority is limited under the Trust to appointing and removing the trustees, and amending and terminating the Trust.

The County Attorney for Yavapai County has interpreted the role of the trustees in the following manner:

The Trustee, in his fiduciary capacity, should not be subservient to the School Board. . . . However, the powers of the Board must not interfere with the Trustee provided for by law. . . . It is my opinion that . . . the program must be established by the School Board, which would set forth the framework within which the EBT Board would operate. Once the parameters are set up and the trust is established, the trust has an existence separate from the district. . . .

The Arizona Supreme Court has made it clear that the trustees owe their first duty and a duty of undivided loyalty to the beneficiaries of the Trust and not the Governing Board or the school district.[3] It appears obvious that this is the reason why the legislature limited the Governing Board and school district's participation to two of five trustees. A.R.S. §15-382 is clear evidence of legislative intent to keep the two entities separate; to allow the trustees of the Trust to function in a fiduciary capacity with priority concern and emphasis

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In Attorney General Opinion 81-141, the function of a benefit trust is explained in light of Arizona case law as follows:

The trust has equitable obligations to the beneficiaries and its assets may not be treated as assets of the district.

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directed toward the best interests of the Trust beneficiaries, free from the vested and parochial interests of a school board. Stated another way, subject to its overall budgetary authority, and its authority to appoint and remove independent trustees and terminate the Trust, it is our opinion that once the Governing Board established the Trust, it relinquished any authority it might have otherwise possessed over the administration of the employee benefit plans funded through the Trust, and shifted such authority to the trustees of the Trust.

Applying the foregoing principles to the current disputes between the Governing Board and trustees, it is our opinion that the trustees of the Trust possessed the exclusive authority to determine whether to increase the costs of dependent health care coverage for employees participating in the Trust. The trustees retained a competent professional actuary to analyze the cost needs of the Trust and adopted the actuary's recommendation that no increase in dependent care coverage was needed. This decision is vested in the trustees under Section 3.02 of the Trust, subject to the Governing Board's concurrence. Assuming that this concurrence authority applies to a zero increase or decreases as well, the Trust and Arizona law do not give the Governing Board unilateral authority to overrule the decision of the trustees and implement an increase which the Governing Board deems appropriate. It is the trustees, and the trustees alone, which are vested with the responsibility to act with undivided loyalty toward the Trust beneficiaries. The Governing Board owes its primary allegiance and duty to the residents of the school district. It is this potential for conflict of interest which led the Arizona legislature to segregate the Trust and its administration from the control of the Governing Board. Thus, it is our opinion that the Governing Board's sole recourse is to terminate the current trustees and appoint new independent trustees if it cannot reach agreement with the trustees over employee funding of the Trust programs. It would then be up to the new trustees to determine the appropriate increase, if any, that is needed under Section 3.02 of the Trust.

It is also our opinion that the Governing Board does not possess the power or authority to unilaterally implement increased participation in certain programs provided by the Trust. Section 1.01(g) gives the trustees the power to approve any program before it can become part of the Trust. If the trustees do not believe it is in the best interest of the current beneficiaries to increase the Trust's coverage to include a limited category of part-time employees of the Washington District, the Governing Board may not overrule this decision and unilaterally add these employees to the Trust. Again, the Governing Board's sole remedy is to remove the current trustees, and appoint new independent trustees who may or may not agree with the Governing Board's decisions. The final

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decision regarding any issue relating to the administration of the Trust must be made by independent trustees who owe their sole allegiance to the Trust beneficiaries.

This is not to say that the trustees could unilaterally adopt new costly programs or significantly increase benefits of existing programs without the prior approval and authorization of the Governing Board. As noted above, A.R.S. §15-382 vests in the Governing Board ultimate responsibility for the cost of the benefits provided by the Trust. We believe an important distinction exists, however, between the power to set overall budgetary constraints, and the power to administer the Trust. The latter authority may not be used by the Governing Board as an overall umbrella which grants to it the power to interfere in any administrative decision which may be made by the trustees, since almost any decision made by the trustees, whether it be investment, ministerial or administrative, directly or indirectly affects the costs of benefits provided by the Trust.

The trustees' decision, for example, not to increase the cost of dependent care coverage could indirectly affect the overall cost of the Trust programs. When such decision is made, however, taking into account an independent actuary's recommendation after carefully analyzing better than expected investment performance and Trust experience gains (i.e., less claims filed and illnesses incurred than projected), it is our opinion that such a decision is an administrative decision within the power of the trustees, and not a budgetary decision within the power of the Governing Board. We believe that the Arizona legislature intended for the Trust beneficiaries to benefit from positive investment and experience performance, not the residents of the Washington District. And, as discussed above, the Governing Board always has the power to remove the trustees or terminate the Trust in the event the trustees attempt to abuse their administrative authority. The trustees do not have a similar check against the Governing Board if it abuses its authority.

In sum, the Governing Board has the authority to determine in the first instance whether to establish a self-insured trust. However, once it makes such a decision, and subject to its overall check and balance budgetary authority to remove the trustees and/or terminate the Trust, it is our opinion that the Governing Board relinquished any authority over the administration of employee benefit programs funded through the Trust as soon as it was created, and that such authority is vested exclusively in independent trustees who possess a fiduciary obligation and undivided loyalty to the Trust's beneficiaries, a loyalty that the Governing Board cannot possess, due to its obligations to the residents of the Washington District. Thus, we believe the Governing

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Board erred by unilaterally increasing dependent care coverage and by unilaterally changing the Trust's eligibility requirements to add certain part-time employees to the Trust's coverage.

If you have any questions or comments concerning the matters discussed herein, please contact me.

Very truly yours,

David E. Weiss

DEW/wp